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Road map to an integrated budget: cost classification and results-based budgeting

Joint report of UNDP, UNFPA and UNICEF

Summary

The Executive Boards of the United Nations Development Programme (UNDP), the United Nations Population Fund (UNFPA) and the United Nations Children's Fund (UNICEF), in decisions 2009/22, 2009/26 and 2009/20, respectively, requested the three organizations to work together to present, for information, a note outlining a "road map" to achieving the objectives outlined in the above-mentioned decisions. The decisions requested greater harmonization and improvement in the presentation of the biennial support budget, 2012-2013, as well as work towards presentation of a single, integrated budget for each organization beginning in 2014.

At the first regular session 2010, the three organizations presented the joint road map, which was endorsed by the Executive Board of UNDP/UNFPA in decision 2010/2 and by the Executive Board of UNICEF in decision 2010/5. The road map proposed that the organizations submit a joint report to the second regular session 2010 of the Executive Board, describing:

(a) Proposed cost definitions and classifications of activities and associated costs for inclusion in the 2012-2013 budget documents of the organizations;

(b) Results of the review of results-based budgeting models and methodologies and the implications for improved linkages between the institutional and management results in the strategic plans and the resources required to achieve the results.

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The present joint report is in direct response to the above request and includes a proposal on harmonized cost definitions and classification of activities and associated costs for review and approval. A proposal is included regarding results-based budgeting for the 2012-2013 biennium budget, which will also serve as an interim step towards a fully integrated budget submission for the period beginning in 2014.

Purpose

1. In response to decision 2010/2 of the UNDP/UNFPA Executive Board and decision 2010/5 of the UNICEF Executive Board, and as outlined in the joint "road map",[1] the three organizations jointly reviewed (a) the existing cost definitions and classification of activities and associated costs; and (b) results-based budgeting models and methodologies of selected United Nations organizations and bilateral donors in order to identify best practices.

2. The results of the above-mentioned review are presented below in section I, which addresses the review of cost classification, and section II, which addresses the findings of the review of results-based budgeting models and methodologies. Section III summarizes recommendations for consideration by the Executive Board.

I. Cost classification

Background

3. In order to harmonize the cost classification categories and their definitions, the three organizations undertook a careful review of the cost classification categories currently in use by the three organizations. The review included information on the experiences and practices of several external organizations, which served as a useful benchmark (see DP/2009/30, annex 3).

4. All three organizations adopted harmonized cost classification categories (see DP/1997/10 and DP/1997/10/Add.1 and E/ICEF/1997/AB/L.3 and E/ICEF/1997/AB/L.3/Add.1) approved by the respective Executive Boards in 1997. These cost classification categories are the following: (a) programmes; (b) programme support; and (c) management and administration of the organization. Until the 2010-2011 budget, the budget preparation of the three organizations was guided by the classification agreed in 1997. With the introduction of results-based budgeting starting in 2008-2009, the biennial support budgets of the three organizations were presented along the lines of 16 harmonized functions, replacing the previous presentation that used the above-mentioned cost classification categories. However, the harmonized categories remained the backbone of the budgets for UNICEF and UNFPA and are still included in the Financial Regulations and Rules of the three organizations. UNICEF reports expenditures against these categories in its financial statements.

5. UNDP presented a new cost classification model to the Executive Board at the second regular session 2009, in the report on the methodology and approach to the UNDP biennial support budget, 2010-2011 (DP/2009/30). The UNDP/UNFPA Executive Board endorsed the approach in decision 2009/22. The new cost classification model was applied by UNDP in its 2010-2011 biennial support budget. The cost classification model comprises the following: (a) Development activities with sub-classifications of (i) programme and (ii) development effectiveness; (b) management; (c) special purpose; and (d) United Nations development coordination.

[1] UNDP, UNFPA and UNICEF, "Joint information note of UNDP, UNFPA and UNICEF: Road map to an integrated budget" (15 December 2009).

Principles

6. In reviewing the two models and related pros and cons, UNDP, UNFPA and UNICEF identified some key principles to guide the development of harmonized cost classification categories and definitions, namely:

(a) The cost classification categories should provide information that would **support strategic decision-making** by the Executive Boards and by the respective organizations;

(b) There is a need to create a basis for **reasonable comparison** of estimates among organizations and changes over time within the same organization;

(c) The approach needs to be **practical, transparent and simple** so as to ensure that the application of the classification and reporting thereon result in meaningful, consistent estimates;

(d) The cost classification and funding frameworks should **align** with the business model and the strategic plan results, within an integrated budget framework;

(e) The categories and definitions should facilitate measurement of organizational **efficiency**.

7. In applying the above principles, the three organizations agreed that the new cost classification model endorsed by the UNDP/UNFPA Executive Board reflects the above principles and thus provides a good basis upon which to further harmonize. The definitions require adjustment to broaden applicability to all organizations, and ensure reasonable comparability.

Proposed cost classification categories and definitions

8. The paragraphs below outline the broad proposed costs classification categories and definitions. Annex I further elaborates on these definitions, summarizes the current practices of the three organizations and the respective actions that each organization will undertake in order to adopt the proposed harmonized cost classification model.

9. **Development activities.** These comprise costs associated with "programmes" and "development effectiveness" activities which contribute to the effective delivery of development results, as follows:

(a) *Programmes*: activities and associated costs traced to specific programme components or projects, which contribute to delivery of development results contained in country/regional/global programme documents or other programming arrangements;

(b) *Development effectiveness*: the costs of activities of a policy-advisory, technical and implementation nature that are needed for achievement of the objectives of programmes and projects in the focus areas of the organizations. These inputs are essential to the delivery of development results, and are not included in specific programme components or projects in country, regional, or global programme documents.

10. **United Nations development coordination.** This comprises activities and associated costs supporting the coordination of development activities of the United Nations system.

11. **Management.** This comprises activities and associated costs whose primary function is the promotion of the identity, direction and well-being of an organization. These include executive direction, representation, external relations and partnerships, corporate communications, legal, oversight, audit, corporate evaluation, information technology, finance, administration, security and human resources.

12. **Special purpose.** This covers activities and associated costs of a cross-cutting nature that (a) are mandated by the General Assembly (i.e., not within the direct management control of the organizations); (b) involve material capital investments; or (c) do not represent a cost related to the management activities of the organization.

Benefits of the proposed cost classification

13. The cost definitions and classification of activities and associated costs have been developed in line with the key principles outlined in paragraph 6 above and reflect the objective of presenting an integrated budget, effective as of 2014, which would reflect the totality of the resources available to the organizations and how these will be used to contribute to the results articulated in the strategic plans of the organizations. Thus, the cost definitions and classification of activities and associated costs should facilitate strategic decision-making.

14. The organizations are of the view that the proposed harmonized cost classifications are practical and transparent, and are aligned to reflect clearer linkages with the respective results to which they contribute.

15. The proposed definition of "management" and classification of related costs also better reflect the management and administration costs of the organization; they can serve as an input in measuring the operational efficiency of the organizations.

Application of the proposed cost classification categories

16. In preparation for this report, in 2010 the three organizations undertook an in-depth review of how they currently apply their respective cost classification models. As a result of the earlier harmonization efforts, it was confirmed that there is already a reasonable level of comparability among the three organizations. The annex to the present report summarizes the current practices of the three organizations and the respective actions that each organization will undertake in order to adopt the proposed harmonized cost classification model. Finally, the organizations are of the view that the application of the proposed cost classification model represents an important step forward in classifying costs in a uniform and harmonized manner, bearing in mind the mandates and business models of each organization.

17. Pending the presentation of the integrated budget in 2013 for the biennium 2014-2015, application of the revised cost classification in 2012-2013 may require some changes in the way various budget components of this new model are approved by the Executive Boards of UNFPA and UNICEF.

II. Results-based budgeting — improving the results focus

Background

18. The Executive Boards of UNDP, UNFPA and UNICEF have requested the organizations, in decisions 2009/22, 2009/26 and 2009/20, to improve results focus and enhance linkages with management results of the strategic plan and to improve linkages between resources and results.

19. In the road map to an integrated budget 2014, the three organizations committed to "review the results-based budgeting models and methodologies of selected United Nations organizations and bilateral donors" in order to identify best practices.

20. The organizations also committed to reporting to the Executive Board by way of the present report on the "results of the review of results-based budgeting models and methodologies and the implications for improved linkages between the institutional and management results in the strategic plans and the resources required to achieve the results"

Review of results-based budgeting models and methodologies

21. For the present analysis, UNDP, UNICEF and UNFPA contacted development partners and other United Nations organizations, requesting them to share the results-based budgeting practices and experiences that could be applied to similar efforts being undertaken by UNDP, UNFPA and UNICEF. The three organizations are grateful for the information shared.

22. It was apparent that all organizations in the review currently face, or have faced in the past, similar challenges in applying results-based budgeting. A number of common lessons can be drawn, namely:

(a) While most organizations are moving towards results-based budgeting as a way to provide more transparency and improve planning, there does not seem to be a widely recognized benchmark in this area. In this sense, results-based budgeting seems to be a work-in-progress for most organizations, as it continues to be for UNDP, UNICEF and UNFPA;

(b) Governments are moving towards results-based budgeting in order to provide better information to their constituents regarding the use of government funds. Within this context, contributions from donors to multilateral organizations need to be justified in terms of the results that the use of such funds are expected to achieve. It is therefore important for United Nations organizations to develop, and submit to their respective Executive Boards, a consolidated framework that provides information across the entire spectrum of results and resources, rather than take a piecemeal approach for different funding sources or appropriations containing different levels of budget and results information;

(c) In all organizations reviewed, resources are first allocated globally to a number of cost categories based on previous budgets or expenditure patterns as well as on certain organizational strategic priorities, and not on the costing of results or outputs. Individual units then prepare their budgets within the allocated envelope based on a base budget, efficiencies, strategic projects and/or anticipated cost of outputs. One of the organizations reviewed places higher emphasis on output costing

when developing unit budgets, which are then aggregated to constitute a global, corporate funding proposal. That organization acknowledged that instituting a practice of developing and managing budgets based on output-costing entailed a long and highly complex change management process within the organization, and a heavy customization of the Enterprise Resource Planning systems, as well as complex operational processes to support the model.

Improving linkages between budget results and the management results of the strategic plan

23. UNDP, UNICEF and UNFPA submit to their respective Executive Boards strategic plans that contain the results frameworks for the planning period, which are divided into development results and management, or institutional, results.

24. Ideally, biennial support budget results would be drawn directly from the management or institutional results frameworks of the strategic plans. However, the organizations developed budget-specific results, as the biennial support budgets were more encompassing than the management results frameworks in strategic plans. This weakened the direct linkage between the two sets of results. In addition, the different timings in the tabling of strategic plans and biennial support budgets hindered full alignment between the two frameworks.

25. In order to assess the performance of individual organizations, some donors have requested, and continue to request, that organizations develop separate performance frameworks, in addition to those of the strategic plans or biennial support budgets.

26. Thus, multiple results and performance frameworks (strategic plans, biennial support budgets and donor-specific performance frameworks) currently coexist for activities that are similar in nature, each entailing separate discussions, consultations, approval, monitoring and reporting. Such fragmentation of frameworks and proliferation of results and indicators have resulted in increased transaction costs for organizations, weakened strategic focus and added complexity in managing for results.

27. Based on the above lesson learned, UNDP, UNFPA and UNICEF are proposing that strategic plans constitute the single, overarching results frameworks for each of the three organizations. Budgets would be the funding vehicles to achieve the results of the strategic plans, and therefore would not need to contain separate results frameworks.

28. For this model to succeed, it is important to ensure that strategic plan indicators are measurable, specific and meaningful. For UNFPA and UNDP, the upcoming review of the strategic plans will provide an opportunity to strengthen the results frameworks. UNICEF revised its results framework following the midterm review of its plan in 2008 and updated them again following the recently concluded in-depth review of the strategic plan (E/ICEF/2010/10).

Improving linkages between resources and results

29. Lessons learned both from the above-mentioned reviews undertaken with development partners and the experiences of the organizations with results-based budgeting can be briefly summarized as follows:

(a) It is possible to link global budgets and results at the output level, and organizations have gone to various degrees of detail in trying to establish such a link. The challenge, however, is that inputs (in particular, staff) contribute to the delivery of many outputs for any given planning period. Thus, in order to establish a linkage between budgets and outputs, it would be necessary to estimate the time contributed by each staff member in delivering the various outputs contained in any given plan;

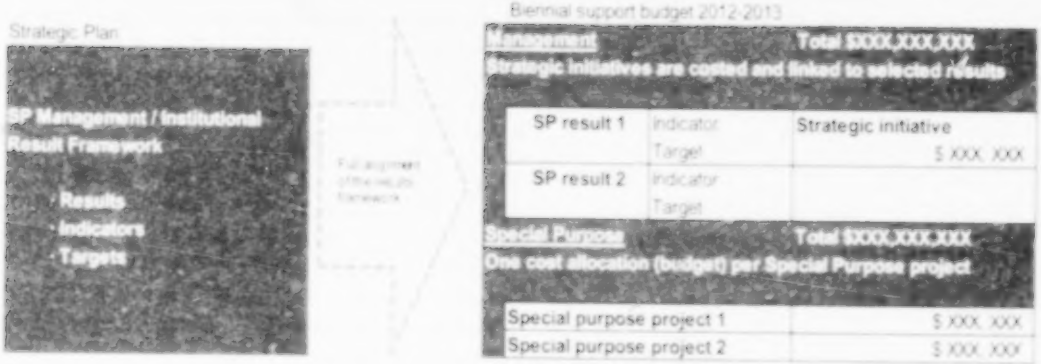
(b) In the absence of timesheets or similar time-tracking mechanisms, it is not possible to monitor and report budget estimates by output versus actual expenditure against those estimates. Even if timesheets were to be established, financial management systems would need to be capable of managing a highly complex accounting model, whereby salaries and operational expenditures would need to be allocated based on their contribution to the various planned outputs. While this is not an impossible task, it is a highly costly and complex system, the desirability of which would need to be assessed in the context of the investment and the effort that such undertaking would require;

(c) In order to identify results areas, UNDP, UNFPA and UNICEF had defined 16 functions in their biennial support budgets. The costing of these functions is to a large extent mapped to individual units and is generally harmonized. The fragmentation of the budget into 16 functions encouraged the proliferation of results and indicators which were not always of strategic importance. While it is possible to assign budgets to functions, the same is not true when it comes to assigning budgets to the results pursued by the units performing these functions.

30. In spite of the limitations highlighted above, there is value in exploring ways to strengthen the linkage between resources and results, bearing in mind the practical limitations of any results-based budgeting model. An integrated framework would link all cost categories (development activities, management, special purpose, etc.) with indicators of performance.

31. For the 2012-2013 biennium, and as an interim step towards an integrated budget, UNDP, UNICEF and UNFPA will develop their support budgets based on the management results of the strategic plan. The budgets would no longer contain the 16 functions per se, but rather would concentrate on identifying the level of resources needed to deliver the results of the strategic plans.

32. Some of those results might entail investments classified as "special purpose"; others might entail strategic investments within the management budgets, and still other strategic plan results might be achieved by improving existing processes. The corresponding allocations by cost category will be presented as part of the support budget submission. Below is a graphic representation of the proposal for 2012-2013:



33. Looking at 2014 and beyond, and within the context of the integrated budget, UNDP, UNICEF and UNFPA hold the view that there is value in developing an integrated framework that links all cost categories (development activities, United Nations development coordination, management, special purpose) with their corresponding results and indicators of performance. Such a framework would provide the Executive Board with an overview of the relationship between results and resources at the corporate level. This holistic approach would show one single, consolidated view of how organizations plan to utilize resources and the measures of performance that are associated with the success of those plans.

34. While this is still an early vision of a possible approach, and more work will need to be done in this area, the three organizations will continue to look into ways to integrate results and resources in a one comprehensive and meaningful results-based budgeting model.

III. Recommendation

35. The Executive Board may wish to:

(a) Take note of the analysis contained in present document;

(b) Endorse the cost definitions and classification of activities and associated costs, as proposed in the present report (E/ICEF/2010/AB/L.10), for application effective in the 2012-2013 biennium, as follows:

(i) Development activities: (a) programmes, (b) development effectiveness;

(ii) United Nations development coordination;

(iii) Management;

(iv) Special purpose;

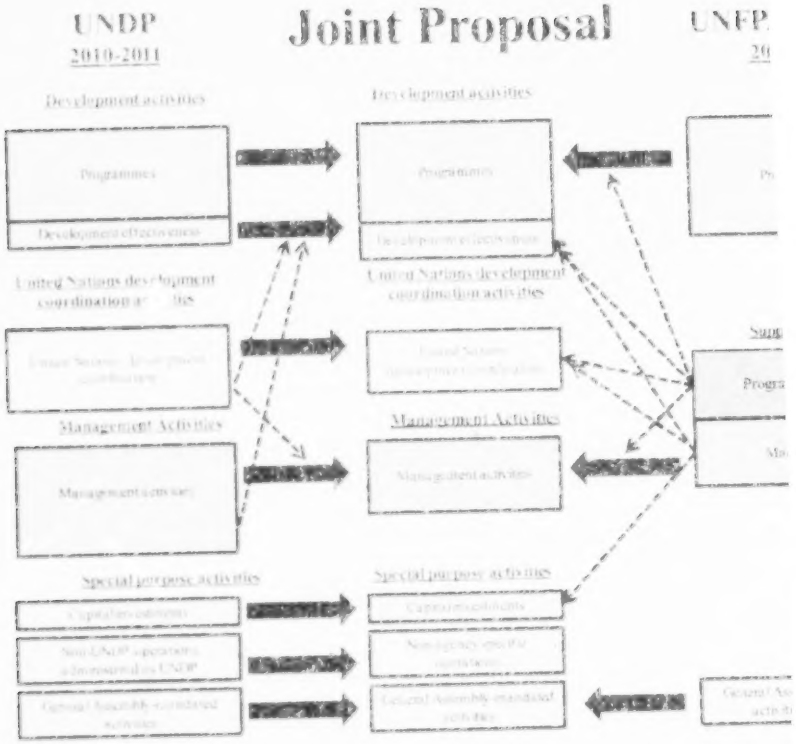
(c) Endorse the proposed approach to the biennial budget, 2012-2013, as follows:

(i) Budgets will align with results in the strategic plans of the organizations;

(ii) Budgets will link management resources, including strategic initiatives and "special purpose" projects, to the selected strategic plan outputs and will thus no longer be apportioned according to 16 functions.

Annex

Summary of actions required to apply harmonized cost classifications



I. Development

1. The broad classification of "development" comprises two sub-classifications: "programmes" and "development effectiveness". The application by the organizations of the classification of costs within the two sub-classifications is detailed below. The organizations will be largely harmonized on the classification of activities and associated costs related to the broad classification of "development".

A. Programmes

2. Further to the broad definition included in paragraph 9, this category include activities such as programme formulation, implementation, monitoring and evaluation, and programme and technical policy advisory services, which are funded from country/regional/global programmes or other programming arrangements a direct costs. Examples include supplies and equipment, subcontracts, cas

assistance, programme and technical advisers, monitoring and evaluation advisers, related support staff and operational costs.

Current practice

3. UNDP, UNFPA and UNICEF currently classify as "programmes" all activities and associated costs contributing to development results and funded from country/regional/global programmes and other programming arrangements.

4. UNDP and UNFPA currently fund some programme policy and technical advisors under global and regional programmes, using regular resources, and classify these as "programmes".

5. UNDP also funds posts and related costs from regular resources under other fixed-line programming arrangements and classifies these as "programmes".

6. UNFPA currently funds, from the biennial support budget, some posts that provide programme policy and technical/thematic advisory support and classifies these as "programme support". UNFPA also funds some posts providing programme policy and technical advice at country level from programme resources (regular resources) in the country programme documents.

7. UNICEF funds posts providing programme policy and technical advice at country level from programme resources (regular and other resources) in the country programme documents and funds posts providing programme policy and technical advisory support at regional and headquarters under the biennial support budget.

8. UNICEF prepares, on a biennial basis, a document on "advocacy, programme development and intercountry programmes". Posts supporting the activities of this programme are currently funded from other resources or the biennial support budget. Posts funded from the support budget are classified either as "management" or as "programme support", depending on the organizational unit to which these posts belong.

Result of harmonization

The organizations have agreed that all activities and associated costs of country, global and regional programmes and other programming arrangements will be classified as *programmes*:

(a) UNFPA will identify programme/thematic posts and related costs currently funded from the biennial support budget and classified as *programme support* and shift these to *programmes*. In order to further harmonize with UNDP and UNICEF, UNFPA will also explore various funding options resulting from this revised classification as appropriate;

(b) UNICEF will identify posts and related costs that are currently funded under the biennial support budget and provide direct support to the implementation of the activities contained in its "advocacy, programme development and intercountry programmes" document and classify these as *programmes*. In order to further harmonize with UNDP and UNFPA, UNICEF will also explore the need to establish other global/regional and/or other programming arrangements resulting from this classification.

B. Development effectiveness

9. Further to the broad definition included in paragraph 9, this category includes overall programme coordination and policy formulation, communication, centralized procurement of programme supplies, as well as programmatic and technical guidance. Examples include deputy representative, deputy regional directors, communications staff, organizational units (or posts) responsible for programmatic and technical policy formulation and advice, as well as related support staff and operational costs.

Current practice

10. UNDP introduced and defined, and the UNDP/UNFPA Executive Board approved, "development effectiveness" as a category of activities and associated costs distinct from "programmes", as explained in further detail in DP/2009/30, annex 1. This category includes activities and related costs of policy advisory services and normative work, as well as advocacy and technical support costs incurred during identification, formulation, management and implementation of programmes or projects. It includes programme development and implementation activities as well as programme policy advisory services.

11. UNICEF and UNFPA do not currently use this cost classification category. At the country level, the above activities are funded within country programmes and classified as "programmes" (in UNFPA some are classified as "programme support" as mentioned in paragraph 6 above). Organizational units and staff implementing above activities at the regional as well as at the headquarters level are currently classified as "programme support" and are funded from the biennial support budget.

12. UNDP and UNICEF currently classify activities and associated costs related to programme policy formulation as "management". UNFPA currently classifies them as "programme support".

Result of harmonization

The organizations have agreed that all activities of a policy-advisory, technical and implementation nature essential to the delivery of development results that are not included in specific country, regional, or global programme documents will be classified as *development effectiveness*:

(a) UNFPA and UNICEF will classify costs of deputy representative (programmes) and communication staff at country level as *development effectiveness*. These are currently classified by UNFPA/UNICEF as *programme support*. UNDP is still assessing this proposal, which would reclassify similar activities and related costs from *management* to *development effectiveness*;

(b) UNICEF and UNFPA will classify programme and technical advisers based in regional support centres (regional offices) as *development effectiveness*;

(c) UNFPA and UNICEF will classify deputy regional directors who are performing an overall programme development and guidance role, as well as the centralized programme supplies procurement function, as *development effectiveness*;

(d) UNDP will continue to classify deputy regional directors and procurement activities as *management*;

(e) UNFPA and UNICEF will classify activities and associated costs of whole units at headquarters responsible for programme and technical policy formulation and guidance as *development effectiveness* in line with the proposed principle of ensuring that the application of cost classification is simple and practical. UNICEF will shift some of these costs to *interregional programmes*, as appropriate;

(f) UNDP will classify activities and associated costs of whole posts at headquarters responsible for programme and technical policy formulation and guidance as *development effectiveness*. UNDP will continue to classify the cost of posts related to leadership and operations functions within programme and technical policy formulation units at headquarters as *management*. UNDP will shift activities and costs associated with time spent by UNDP staff in participation in the United Nations country team which are presently classified as *United Nations development coordination* to *management* or *development effectiveness*, as appropriate;

(g) Classification of programme development and implementation as well as programme policy advisory services at country level will remain a function of the respective business models of the agencies. UNICEF and UNFPA will continue to classify these as *programmes*. UNDP will classify these as *development effectiveness*. However, these activities and their corresponding costs will be consistently classified under the broad classification of *development* by all three organizations.

II. Management

Current practice

13. UNFPA and UNICEF currently classify representative, deputy representative and operations support staff (administration, finance, information technology and human resources) at country level as "programme support". UNDP classifies these as "management".

14. UNFPA and UNICEF classify regional directors, deputy regional directors and operations support staff in regional offices as "programme support". UNDP classifies these as "management".

15. UNDP, UNFPA and UNICEF are consistent in classifying the following functions at headquarters as "management": executive direction, representation, external relations, fund-raising, corporate communications, legal, oversight, audit,

corporate evaluation, information technology, finance, administration, security and human resources.

16. UNDP and UNICEF currently classify organization units performing programme policy formulation as "management". UNFPA currently classifies them as "programme support".

Results of harmonization

The organizations have agreed to classify all activities and associated costs related to the promotion of the identity, direction and well-being of an organization as *management*. These include executive direction, representation, external relations and partnerships, corporate communications, legal, oversight, audit, corporate evaluation, information technology, finance, administration, security and human resources:

(a) UNICEF and UNFPA will classify costs of representative and operations staff at country level as well as regional director and operations staff at regional office level as *management*, following the practice of UNDP;

(b) UNDP will shift activities and costs associated with time spent by UNDP staff in participation in the United Nations country team from United Nations development coordination to *management* or *development effectiveness*, as appropriate.

III. Special purpose

Current practice

17. UNDP classifies General Assembly-mandated costs, capital investments and non-UNDP operations administered by UNDP as "special purpose".

18. UNFPA and UNICEF currently do not use the "special purpose" category. Capital investments (one-time costs) are currently classified as "management and/or programme support" and United Nations-mandated security costs are classified as "security".

Results of harmonization

UNFPA and UNICEF will classify General Assembly-mandated costs and capital investments as *special purpose*.

IV. United Nations development coordination

19. Further to the broad definition included in paragraph 10, this category includes staff within the resident coordinator office, and other staff (full-time equivalent) and related costs that are apportioned for the support to the resident coordinator function and United Nations Development coordination activities. More work remains to be done to encompass all costs related to this category.

Current practice

20. UNDP currently classifies costs associated with coordination activities mandated by the General Assembly as the sole responsibility of UNDP, and UNDP participation in the United Nations country team as "United Nations development coordination". UNDP apportions country office costs, based on a workload study, between "United Nations development coordination" and other categories ("management" and "development effectiveness"), using the "full-time equivalent" method.

21. UNFPA and UNICEF staff and activities supporting United Nations coordination activities such as thematic cluster leads and other United Nations coherence/coordination activities, and participation in the United Nations country team, are currently classified as "programme", "management" or "programme support" using the "whole post" approach (predominant area of work/functional job title). Currently, UNFPA and UNICEF do not reflect any costs under the category "United Nations development coordination".

Results of harmonization

The organizations have agreed that *United Nations development coordination* will include activities and associated costs supporting the coordination of development activities of the United Nations system. Agency-specific costs associated with participation in the United Nations country team will be excluded:

(a) UNDP will shift activities and costs associated with time spent by UNDP staff in participation in the United Nations country team to *management* or *development effectiveness*, as appropriate;

UNFPA and UNICEF will need to further review this category and identify activities and associated costs that are incurred in support of *United Nations development coordination* and classify them accordingly.